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February 24, 1999

Dear Ms. Xxxxx:

This letter is in response to your letter dated February 25, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

The purpose of this letter is to request a ruling on the taxability of specific types of software sales transactions that our company intends to enter into in Illinois during 1999. We contacted the Illinois Department of Revenue by telephone on January 25, 1999, and were instructed to contact your department directly because the representative we spoke to was unable to determine the taxability of each of the following specific types of software sales transactions.

Our company develops and sells software that tracks and reports on website activity. Our salespeople sell the software by phone, and our company transfers the finished, customizable software to our customers by downloading it to them over the Internet. We ship packaged software and related manuals in less than 10% of our total sales transactions. We also significantly customize at least 50% of the software originally downloaded over the Internet by sending consultants to do the work at the physical customer location. We are trying to find out which of these transactions is taxable, if any, and to what extent. Any assistance your department can give us regarding the taxability of the types of transactions described above would be greatly appreciated.

To date, our company has had no sales in the state of Illinois. However, we plan to open a sales office in the general Chicago area during 1999, and have taken steps to file our NUC-1 Illinois Business Registration.

Thank you.

Enclosed, please find a copy of 86 Ill. Adm. Code 130.1935 regarding computer software. This regulation states, in part, as follows:

Computer software means all types of software including operational, applicational, utilities, compilers, templates, shells and all other forms. Canned software is considered to tangible personal property **regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media.** The sale at retail, or transfer, of canned software intended for general or repeated use is taxable, including the transfer by a retailer of software which is subject to manufacturer licenses restricting the use or reproduction of the software. (Emphasis added).

Generally, sales of "canned" computer software are taxable retail sales in Illinois regardless of the form in which the software is transferred. Sales of canned computer software that are transferred or downloaded over the Internet are taxable sales in Illinois. See the enclosed copy of 86 Ill. Adm. Code 130.1935. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c).

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3).

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax.

A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party);
- D) The vendor will provide another copy at minimal or no charge if the customer loses or damages the software; and
- E) The customer must destroy or return all copies of the software to the vendor at the end of the license period.

As stated above, licenses of computer software are not taxable if they meet all of the criteria listed in Section 130.1935(a)(1). However, item (D) of that part requires the license to contain a provision requiring the vendor to provide another copy at minimal or no charge if the customer loses or damages the software. The Department has deemed software license agreements to have met this criteria if the agreements do not contain a provision about the loss or damage of the software, but the vendors' records reflect that they have a policy of providing copies of software at minimal or no cost if the customers lose or destroy the software.

Item (E) of this part also requires a license to require a customer to destroy or return all copies of the software to the vendor at the end of the license period. The Department has also deemed a perpetual license agreement to qualify for this criterion even though no provision is included in the agreements that require the return or the destruction of the software.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.